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Regulation of the capital requirements of public limited liability companies, as established by the second company law directive (77/91/EEC), amended by directive 2006/68/EC and recast by Directive 2012/30/EU of the European Parliament and of the Council of 25 October 2012 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 54 of the Treaty on the Functioning of the European Union, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent Text with EEA relevance.

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Method

This paper uses an analytical approach to the subject matter based on the knowledge acquired by the reading of the scientific books on the public limited liability company and the main characteristics of its operation. The main rules of the Directive are described and their amendments are analyzed and criticized. Furthermore, it attempts to expose the background of the existing regime and present the discussion on possible developments. This is achieved through a presentation and analysis of the main rulings of the ECJ concerning the subject matter. A number of scientific articles that illustrate the main arguments in favor and against the present regime and comment on future alternatives has been used for this purpose, as well. The criticism on the current regulation is presented and finally a conclusion on the purposefulness of an alternative regime is drawn.

Introduction- Presentation of subject matter

The paper seeks to present the main rules on which the legal capital doctrine is based at the level of the European Union. Creditor and shareholder protection through capital maintenance rules has been a key issue in the harmonization of European company law, in accordance with article 44 par 2 (g) of the Treaty Establishing the European Community (article 50 TFEU), which provides that the Council and the Commission shall carry out their duties ... by coordinating to the necessary extent the safeguards which, for the protection of the interests of members and others, are required by Member States of companies or firms within the meaning of the second paragraph of Article 48 (54 TFEU) with a view to making such safeguards equivalent throughout the Community. One of the objectives of harmonization on company law was to prevent regulatory competition among member states, aiming to attract businesses in the sense of a “race to the bottom” and achieve efficient creditor protection.

The rules on capital formation, maintenance and alteration are established in the Second Company Law Directive, which was published for the first time on 13 December 1976, amended by the Directive 2006/68/EC and recast as Directive 2012/30/EU. The Directive regulates the capital regime of public limited liability companies in the EU and does not apply to private limited companies.

According to the Preamble of Directive 77/91/EEC, its objective is to ensure minimum equivalent protection for both shareholders and creditors of public limited liability companies within the limits of the European Union and to coordinate national provisions relating to the formation, maintenance, increase and reduction of their capital. The Directive includes rules of minimum harmonization, which means that the member states have the power to establish stricter rules in their legislation than those set in the Directive. As a result, the regime of creditor protection in the EU consists of a combination of the rules imposed by the Directive and the national laws adopted by Member-States.

The rules set in the Directive are directed in two components, the raising of the legal capital and the maintenance of such capital, which must be sufficient for the company's operation throughout its life Therefore, they include the requirements for the payment of the initial capital of a public limited liability company, rules on the distribution to the shareholders, on restoration of capital sufficiency, increase and reduction of capital, purchase and redemption of own shares, publicity and registration. In addition to that, the Directive includes rules which, as it is supported do not actually concern the preservation of share capital, as the rules on financial assistance.

The need for capital regulation is related to the capital character of the company, on which the existence and operation of the company is based. Concerning the external relationships of the company, the principle of limited liability applies, according to which the shareholders are not personally liable for the decisions who may cause a corporation to act to the detriment of creditors. As a result, they benefit from the protection offered by limited liability, since they are in fact only liable up to the amount they invest in share capital and not with their personal assets. Conversely, the creditors are restricted to the assets of the company for their claims. A conflict of interests is thus observed between the shareholders and the creditors, concerning the use of capital; shareholders pursue obtaining return on their investment in the company, while the creditors aim at the preservation of share capital to fulfill their claims. The rules on legal capital are orientated to the protection of creditors and are set to mitigate the effects of an automatic application of the principle of non-personal liability of shareholders and directors.

The background

The establishment of capital rules in Europe derives already from the second half of the nineteenth century. Since then rules for the capital formation and limitations on shareholder distribution consist an integral part of the continental European Law. The provisions of the Second Company Law Directive reflect the German Law of the 1970s.

However, developments in the company law have led to the challenging of the legal capital regime in Europe. A number of changes have led to this result. In 2002 the European Union seeking accounting harmonization adopted Regulation 1606/2002 of the European Parliament and of the Council of on the application of international accounting standards, according to which International Accounting Standards/ International Financial Reporting Standards (IAS/IFRS) apply for the consolidated accounts of the EU listed companies. The new standards move from the conservatism principle to the true and fair view.

The reports of the High Level Group of Company Law Experts on a Modern Regulatory Framework for Company Law in Europe, Brussels 2002 and the Rickford "Report of the Interdisciplinary Group on Capital Maintenance", EBLR 2004 fed the discussion on the criticism of the capital maintenance rules even suggesting their abolishment in order to achieve flexibility in European corporate law.

Finally, a series of rulings from the European Court of Justice (Centros, Inspire Art, Uberseering, Sevic Systems) on the EU freedom of establishment allowed national provisions on capital requirements to be circumvented and accelerated developments concerning legal capital. As a result, based on arguments of the cases, with the perspective of a Common Market and the arguments against the efficiency of the legal capital rules the existing capital regime was put in question.

The Centros Case

The freedom of establishment

The freedom of establishment for natural and legal persons, as one of the fundamental freedoms of European law is established in Article 49 of the Treaty of the Functioning of the European Union. The article states that restrictions on the freedom of establishment of nationals of a Member State, within the territory of another Member State, shall be prohibited. The prohibition applies also to restrictions on the setting-up of agencies, branches or subsidiaries by nationals of any Member State established in the Community. This article applies to natural persons, while article 54 applies to legal persons.

According to the ruling of the ECJ (Case C-81/87 Daily Mail, para 15) these provisions have direct effect and as a result Member States must modify their national laws that restrict freedom of establishment and are therefore incompatible with these principles. Restrictions by Member States can be justified only in circumstances of overriding reasons of general interest, as for example on grounds of public policy, public security or public health under the principle of proportionality. As a result, both foreign citizens and companies have equal opportunities to national citizens and companies to practice economic activity in a Member-State.

As regards the connection between a company and a state, two theories are applied within the European Union, the incorporation theory and the real seat theory. According to the first, the state of incorporation has jurisdiction over the company law issues, whereas according to the second, it is the state where the company has its real seat. The Netherlands, the UK, Ireland and Denmark follow the first system in private international law, while the rest of the European countries support the real seat theory. The countries that follow the incorporation theory recognize a company as a legal entity when it is incorporated according to the laws of a specific jurisdiction. The countries that follow the real seat theory consider that the legal personality of the company is bound to the place of its “real seat,” or central administration. Therefore, a company incorporated legitimately under the laws of own country will be obliged to reincorporate under the laws of the real seat country where it seeks to locate its central administration in order to be recognized legally.

The European Court of Justice has rendered a number of decisions on the freedom of establishment, Case C 183/83 Seger, Case C-212/97 Centros, Case C-208/00 Überseering Case C-167/01 Inspire Art which influenced European commercial law. The case law that will be analyzed in this paper is Centros and Inspired Art, as more closely connected to the notion of legal capital.

The facts of the case

The facts of the Centros case are the following: Danish nationals Mr and Mrs Byrde, residing in Denmark sought to establish a (private) company in Denmark. The minimum share capital that the Danish law required upon formation of the company was 28. 000 Euros, in contrast to the English law that has no requirements as to the provision and paying up of a minimum capital as far as private limited companies are concerned. In practice the minimum capital is fixed at £ 100. Therefore, they chose the United Kingdom to establish a private Ltd, with a capital of 100 £ in order to avoid the stricter requirements of Danish Law.

The company, which did not have any real business activity in the UK, made an application to the Registry Office of Denmark for the registration of a branch. The registry refused to register a branch of Centros on the grounds that the company was not seeking to establish a branch in Denmark, but its principal establishment circumventing this way the Danish rules on minimum capital requirements.

In the law suit that followed, Centros argued that the refusal of the Registry was contrary to the freedom of establishment (articles 52 and 58 of the TEC). The Danish Court referred to the ECJ for a preliminary ruling on whether refusal of registration of a branch of a company incorporated lawfully in another Member State with the purpose of conducting its activity solely in the country were the branch is established was contrary to the aforementioned articles, even though there was intention to circumvent the rules on minimum capital.

The decision of the Court

The court held that when a company is formed in accordance with the law of a Member State, has its registered office in that Member and wishes to establish a branch in another Member state falls within the scope of Community law. The fact that the company was formed in the first Member State but pursues its business activity mainly or entirely in the host state is indifferent for the application of the freedom of establishment.

As a result, and taking the Sevic decision into consideration, companies have the right to be incorporated under the laws of one Member- State and exercise their activities through branches, agencies or subsidiaries in another. A refusal of a Member State to register a branch of a company with its registered office in another Member State and incorporated under the laws of that State infringes their right of establishment conferred on them by Articles 52 and 58 of the Treaty, hindering the right to set up a secondary establishment (par 30).

On the objection of the Danish Board that the purpose of establishment in the UK was to circumvent the Danish national law as regards the formation of private limited companies constitutes an abuse of the freedom of establishment and therefore measures by the host state must be taken, the Court ruled that it cannot in itself constitute an abuse to set up a company in a Member State whose company regulations appear to be less restrictive, and then set up a branch in another Member State (par 27).

The Member States have the right to take measures to prevent individuals from circumventing national legislation under the cover of the Treaty rights and from improperly or fraudulently taking advantage of provisions of Community law. However this kind of behavior is evaluated on a case by case basis and based on objective evidence by the national courts. The Court moreover distinguished between of rules relating to the formation of companies and rules concerning the carrying on of certain trades, professions, or businesses. Only the circumvention of the latter rules can be invoked by Member states to impose certain restrictions. The rules on formation of the company, which include the minimum capital requirements of national laws are not related to the freedom of establishment and as a result circumvention of these rules cannot be invoked by a member state to deny access to foreign companies to its territory.

The Danish authority argued that the refusal was justified by imperative requirements in the general interest. As such, they invoked the importance of a minimum capital for the protection of public creditors since, unlike contracting creditors, they cannot secure their debts by means of guarantees. It also protects all creditors in general, by reducing the risk of fraudulent bankruptcy of companies with insufficient initial capital

With reference to previous case law, the ECJ stated four conditions must be fulfilled in order for national rules to hinder or restrict the exercise of fundamental freedoms: First, they must be applied in a non-discriminatory manner, second they must be justified by imperative requirements in the general interest, third they must be suitable for securing the attainment of the objective which they pursue and fourth, they must not go beyond what is necessary in order to attain it.

The Court ruled that the aforementioned conditions were not fulfilled in the specific case. Denmark, as an incorporation country, allows foreign companies to establish branches in its territory. So if Centros had been conducting business in the UK, Danish authorities would have permitted registration of a branch in Denmark. In this case, the Danish creditors would be equally exposed to risk. In addition, it is known to the creditors that Centros is a UK company and therefore governed by English law -and not by Danish law- and they could seek protection under the provisions of the fourth and eleventh company law directives.

Furthermore, the Court held that **it is possible to adopt measures less restrictive, or which interfere less with fundamental freedoms by making it possible in law for public creditors to obtain the necessary guarantees.** The states are not deprived of their right to take **measures to prevent or penalize fraud of the company** if it attempts by means of its formation to evade obligations towards private or public creditors in the territory of the host state. However, combating fraud cannot justify a practice of refusing to register a branch of a company which has its registered office in another Member State.

Following that reasoning, the holding of the Centros ruling was that a company registered in one Member State can set up a branch in another Member State even though it does not conduct any real activity in the home state and aiming at circumventing national rules of the host state.

According to E. Wymeersh, Centros immediately provoked “great waves of unrest on the continent”, since it was considered to promote “forum shopping”, namely the possibility by a company to choose state of incorporation with regards to the most favorable company legislation.

In his article *From Centros to Uberseering : Free Movement of companies, Private International Law, and Community Law*, W.H. Roth states that the decision supports the argument that a minimum capital requirement should be replaced by other effective means of creditor protection that are to be applied by 'depecage' to a company governed by foreign law and interprets the ruling to demand *nothing less than that Denmark replace its regulations on minimum capital applicable to foreign companies by such instruments as guarantees or regulations preventing or penalizing fraud.* The ruling challenged the existence and purpose of the legal capital rules.

The Inspire Art Case

Following the Centros case, Member-States adopted a number of measures to protect their national interests. The legitimacy of such measures was judged in the Inspire Art case.

The Inspire Art did not concern registration of a branch, but the admissibility of special national requirements on pseudo foreign companies. A foreign company is not only a recognized legal entity with the right to be a party to local legal proceedings, as judged in Uberseering, but it must be respected that as a foreign company it is subject to the company law of its state of incorporation. As a result, any adjustment to the company law of the host state is not compatible with European law.

The facts of the case

Inspire Art was a *private* limited liability company, dealing with objects of art and incorporated in the UK. The company immediately after its formation started to conduct its activities in the Netherlands, where its sole shareholder and director was domiciled. Just as in Centros, there was no intention of actual activity in the UK, but only exploitation of the more favorable corporate rules of this state. The company registered a branch in the Registry of the Amsterdam Chamber of Commerce.

The Dutch law Wet op de formeel buitenlandse vennootschappen (WFBV) set a number of requirements on pseudo-foreign companies. First of all, article 1 required disclosure of this fact and article 2 required that the a company is registered with the indication of pseudo-foreign company, Article 4 WFBV required the subscribed capital of a pseudoforeign company to be at least equal to the minimum capital required by the Dutch law for limited liability companies. Non-fulfillment of this condition would entail joint and several liability of the directors.

The decision of the Court

The Court held that Article 1 was in breach of the 11th Directive which did not permit any disclosure beyond what it was provided for. Since a rule for the characterization of Article 1 was not included either in the obligatory nor facultative disclosure requirement, it was inadmissible. Additionally, repeated that in was in accordance with the freedom of establishment that a company is formed in one Member State and exclusively carry on their business in another and that selection by the most favorable rules did not constitute an abuse of this right. The exception of fraud still applied.

According to the ruling, the provisions of Dutch law that required pseudo-foreign companies to have capital at least equivalent to the minimum capital prescribed for Dutch companies with limited liability and the liability of directors infringes the freedom of establishment. On the contrary, the host state must respect the provisions of the incorporation state on these topics. Since the provisions concerning minimum capital were incompatible with freedom of establishment, the same applied to the penalties attached to noncompliance with those obligations, namely the personal joint and several liability of directors. The Court did not find a justification of public interest, according to the four established criteria. Because Inspire Art was presented as a UK company, it was known by the creditors that it was governed by British law.

The Court rejected the arguments of the Dutch Government regarding necessity of national measures to countering fraud, ensuring that tax inspections were to be effective and that business dealings were fair as grounds of public interest, because the establishment of a company in the state with the least restrictive rules does not constitute fraud and the measures that were taken did not satisfy the criteria of efficiency, proportionality and nondiscrimination. Accordingly, the measures taken by the Dutch law, imposing requirements on the UK Company could not be justified and thus were not in conformity with Community law.

In conclusion, **the Court ruled that the conditions set in national law concerning the company formation, which include capital requirements and the liability of the directors were contrary to Articles 43 EC and 48 EC.** Consequently, the freedom of the host Member State to provide for national laws and rules that aim at establishing an efficient creditor protection regime is subject to the limitations resulting from Article 43 et seq. of the EC Treaty. This restriction applies regardless of the categorization of the laws and rules of the host Member State as corporate law, tort law or insolvency law.

Following the progress in the EU, as well as the changes in the United States of America, where although was implemented by the laws of a number of States it was finally abolished as inefficient, led to a discussion on the effectiveness of the existing legal capital regime and the future developments.

The efficiency of the Directive 77/91 regarding the regulation of share capital was challenged. It was argued that the existence of a minimum capital is not always an adequate protection of creditors since the real assets of the company can be proven insufficient, while at the same time there are high administrative costs in order to comply with the rules. Therefore, alternative methods for creditors' protection have been proposed: introduction of the solvency test, use of covenants, granting of securities, personal liability of the management board, measures of disclosure, insurance contracts, and use of the theory of piercing the corporate veil.

The discussion in the EU began in 1997 with the SLIM (Simpler Legislation for the Internal Market) Working Group. Proposals by Professor E. Wymeersch concerned contributions in kind, art

10,11, and 27, the requirement of nominal value or accountable par of shares, art 8, the withdrawal of shares, art 37 (squeeze out), acquisition of own shares, art 19, financial assistance, art 23 and the right of preemption, art 29 (4).

Followed the High Level Group of experts on Corporate Law by Professor Winter that agreed that in short term the proposals of the SLIM group were to be followed, but went further stating that the regime of the legal capital must be repealed and substituted by more effective means of creditor protection such as the solvency test with the governing board's responsibility for the accuracy of the solvency statement. In addition, the Group recommended that, as an element of good corporate governance, a European framework rule should be introduced on "wrongful trading", i.e. on the responsibility of directors close to insolvency, and that subordination of insiders' claims should be at least considered.

The Rickford Report on "Reforming Capital" also supported a regime based on the solvency test.

Finally, the EU Commission, published a tender for a feasibility study for the alternative solutions to the regime of the Second Company Law Directive. The study was conducted by the KPMG accounting company which concluded that the Directive is a flexible instrument, does not require significant compliance costs and does not result in considerable operational problems for the companies.

As a result of the feasibility study, the works did note lead to a complete departure from the minimum capital regulations, but to a series of amendments of the article of the Directive, that were embodied in the amending Directive 2006/68/EU and concerned contributions in kind, share buy backs, financial assistance in the buy backs and regulation of decrease of share capital. The aim was to simplify the rules of contribution and maintenance of the capital in order to facilitate the funding of the public limited liability companies with simultaneous regard to the shareholders' and creditors' protection (Directive 2006/68/EU Recital (2) of the Preamble). These changes are not to be seen only as part of the progressing abolition of the legal capital regime, but also as a part of the companies' mobility, concerning flexibility in the transfer of seat and cross-border mergers.

Raising of subscribed capital

Capital is the fixed amount that has to be gathered at the formation of the public limited company and must remain constant during the life of the company. At the formation of the company it is equal to the sum of the value of the shareholders' consideration. The amount of the capital is defined by the national laws and is provided for by the statute of the company. Article 3(g) of the

Second Directive sets forth that the information regarding the amount of subscribed capital paid up at the time the company is incorporated or is authorized to commence business must appear in either the statutes or the instrument of incorporation. As a result, any alteration in capital, such as increase or decrease can only be realized after amending the statute of the company.

From the accounting perspective, it comprises of equal parts, the shares, each of which represents the minimum consideration to be paid in order for a person to become a shareholder. In return for their investment, shareholders gain a share of the ownership of the company. The number of shares times their nominal value equals the authorized capital of the company. The number of shares held is important as it grants the right to a proportionate vote in company matters. Article 7 requires subscribers of capital to contribute assets of measureable value. Supply of services or performance of work are not acceptable as a form of consideration to fulfill the minimum capital requirement.

According to the rule of article 8 of the Directive, the companies cannot issue shares below their nominal value or where there is no nominal value, their accountable par, with the exemption of the undertakings that place shares in the exercise of their profession. The reference to shares without nominal value concerns the legal orders of Luxembourg and Belgium. The Second Directive explanatory memorandum defines the accountable par as a value obtained by dividing nominal capital by the number of shares outstanding. The prohibition is set to deter concentration of capital lower than it is provided for in the law and the statute of the company. Issuing shares above their nominal value is permitted and includes the payment of a premium, which will lead to the creation of an undistributable reserve -or distributable under strict conditions (heavy taxation).

Not all legal orders provide for the application of a nominal value of shares, as for example the USA, Canada and Japan, where importance is attributed to the number of shares and their character, namely the rights a specific amount of shares grants to their owner. In any case, the extent of the shareholders' participation in the operation of the company depends on the proportion of the shareholding to the aggregate authorized capital. The notions of the nominal value and accountable par have been criticized in Europe, as well. It is supported that, although it is useful for the distinctions of classes of shares, it can cause confusion to investors as to the real value of the shares. The latter does not derive from the amount of capital or own funds that shares represent, but is formed by the laws of offer and demand in the markets according to valuation methods based on future cash flows of the company. Therefore, it has been proposed that the notions of nominal value and accountable par should be set aside, leaving shares to represent just a fraction of the company regarding their value and their voting rights.

According to article 9 (1) of the Directive, shares issued for a consideration must be paid up at the time the company is incorporated or is authorized to commence business at not less than 25 %

of their nominal value or their accountable par. The twenty-five percent was the dominant average in the Member States, when drafting the Second Directive. Concerning the issuing of shares for a consideration in kind, this consideration must be fully paid within five years of the incorporation of the company or the authorization to commence business. The total amount of initial contributions that are paid may not be less than the minimum authorized capital of the company. This requirement of full payment constitutes a form of protection from fraudulent payment and seeks to ensure actual payment by the shareholders. According to article 12 of the Directive, subject to the provisions for the reduction of capital, the shareholders may not be released from their obligation to pay their contributions.

Finally, the share capital is to be distinguished from the total of the corporate assets, which comprise of the cash, factories, machinery and equipment as well as the merchandise and the claims of the company and can increase or decrease through the course of operation of the company, in contrast to the legal capital which remains unchanged by the law. As a result, the aggregate of corporate assets can exceed the share capital, as for example when there are undistributed profits, when the value of the assets has arisen or when there are favorable conditions in the market for the company. If the company has liabilities, the value of the assets can be smaller of the legal capital. The only moment when share capital and corporate assets coincide completely is at the time of the formation of the company and the payment of contributions.

The rules on the raising of capital aim at providing the creditors with information about the value of the assets contributed by the shareholders to the company, which can effect a decision of lending to the company. Professor J. Armour explains that in economic terms, they can be understood as a response to problems of information asymmetry in corporate credit markets, since they publicize to investors the value of the invested assets to the company and seek to ensure that this information is truthful. He remarks, however, that the relevant provisions only assist the consensual creditors, whereas they are not sufficient for the protection of the interests of tort creditors. Furthermore, he adds that the rules can be circumvented by private companies through the use of non-cash consideration, however the rules on expert valuation established by the Second Directive can be seen as a means of plugging this gap, at least in relation to public companies.

The minimum capital requirement

According to Article 6 of 2012/30/EU, which is equivalent to the old article 6 of 77/91/EEC, the Member States are obliged to set as a requirement for the establishment of a public limited company a minimum subscribed capital of not less than EUR 25 000.

In addition to that, Article 17 of the Second Directive provides that in the case of a serious loss of subscribed capital, a general meeting of shareholders must be called within a time period regulated by the laws of the Member States, in order to decide whether the company should be dissolved or other appropriate measures should be taken. The considerable loss of capital within the meaning of the Second Directive, is to be defined by the Member States, but according to the Directive, it may not exceed half the authorized capital.

Other possible measures could be to cover company losses through additional contributions made by the shareholders, to transform the company into a legal person of a different status or to liquidate the company, but it may be concluded that the most suitable *ad hoc* method for the restoration of capital can be chosen based on the company’s financial rates, shareholders’ interests and scheduled investments.

These rules in combination with the rules on expert valuation of the contributions regarding the raising of capital are perceived as a system of creditor protection. Their purpose is to ensure that at least a minimum level of assets is contributed to the public limited company by its shareholders and to set the threshold below which the company’s net assets cannot fall and the general meeting must take suitable measures in order to confront the problem. The regime is set to protect creditors of the company, especially the involuntary creditors.

Considerations other than in cash

Article 7 of the Directive 77/91/EEC sanctions that the subscribed capital may be formed only of assets capable of economic assessment. From article 9 of the Directive derives that the contributions of the shareholders can also consist of non cash considerations. The contributions in kind can either concern the initial payment of the capital or shares acquired at the event of an increase of share capital. The regulation of these contributions is provided for in articles 10 and 27 of the Directive for each of the cases respectively.

According to article 9 (2), the contributions in kind must be paid up in full within five years from the incorporation of the company. Article 10 (1) sets as a presupposition for the valid payment of a contribution in kind an independent expert report by either a natural person or firm appointed or approved by the competent administrative or judicial authority. The report must be edited before the company's incorporation or authorization to commence business. Paragraph 2 regulates the minimum content of the report, which must include description of the assets contributed, the used methods of the valuation and finally state whether the assets contributed correspond to the number and nominal value or accountable par of the shares and the premium when provided for. As a result, overvaluation of the assets is prohibited, but undervaluation is acceptable. The Directive provides for publicity of the report according to the article 3 of Directive 68/151/EEC.

Expert valuation is set to secure that the assets of the company will reflect an amount equal to the capital. The aim is to protect the creditors as well as the old shareholders from the dilution of their share in the company. The independence of the valuation ensures that the estimates of the management board or the contributor will not affect the valuation. However, the effectiveness of the rules is contested, since the expert valuation is not binding on the promoters or the board of the company. The directive does not impose that the valuation must be followed by them, nor provides for any specific sanction. Regulation of these issues is left to national law. The expert's valuation does not necessarily reflect the actual value of the asset, since it is adequate for the expert to state that the value contributed is sufficient to cover the amount of the capital stated in exchange of the contribution.

The article was amended to provide for cases where expert valuation can be considered redundant. Recital (3) of the Preamble of the amending Directive 2006/68/EC states that contributions in kind must not require a special expert valuation, where a clear point of reference for their valuation already exists. The purpose of this change is the payment of these contributions without the costly and time consuming procedure of expert valuation under the anterior rules, with prejudice to the minority shareholders' rights. Article 10a of the Directive (11 in the recast 2012/30/EU) defines three cases where expert valuation can be omitted, assets traded on regulated markets, the prior existing expert valuation and value deriving from the statutory accounts of the company. In these cases, the Member States are provided with the discretion not to apply the expert valuation requirement as regulated in article 10 (1), (2) and (3).

The first case concerns the contribution of transferable securities and money-market instruments as defined in article 4(1) Dir. 2004/39/EC (Markets in Financial Instruments Directive), points 18 and 19 respectively, which are traded in regulated markets (point 14). A characteristic case is the contribution of listed securities, as for example in a share for share exchange offer. These transactions take place rapidly under possibly fluctuating market prices, therefore the requirement for an expert valuation hampers them unnecessarily. According to article 11 par 1 of the Directive (former 10a par 1), expert valuation is not obligatory when these assets are valued at the weighted average price at which they have been traded on the stock exchange market for a sufficient period, which must be defined by national laws, before their contribution. This period is usually ranges from twenty to thirty trading days before the transaction.

There are objections in theory and case law as to whether the weighted average price of the shares is their objective price and there is no common scientific method for the valuation. While the valuation must take place at the weighted average price, it is not settled in the Directive whether the contributions must necessarily take place at that price as well or securities can be contributed at a lower value, thus benefiting the existing shareholders. Without being explicitly regulated in the Directive, according to Professor Wymeersch contributions below market price without expert valuation are acceptable, since they do not inflict damages to shareholders and creditors, whereas the same does not apply for contributions above the market price.

Nevertheless, it is provided by the Directive that when exceptional circumstances affect the price of the assets and this would result in a significant change of value of the offered asset at the time at which it is contributed, the management board is obliged to instruct revaluation following the rules on expert valuation. The Directive includes the example of the illiquidity of the relevant market. As exceptional circumstances to significaly affect the price of the assets could be regarded a sudden increase or decrease of the closing price the last day before the contribution, in comparison to the prior average price. Then revaluation must follow.

Secondly, assets except for the securities and the market instruments, can be exempt from the valuation proceeding if a series of conditions is fulfilled. They must have already been subject to a fair value opinion by a recognized independent expert, the fair valuation must have taken place not more than six months before their contribution was effected and been performed according to generally accepted valuation standards and principles implemented by the laws of the Member States.

The fair value standard refers to the IFRS rules that were adopted in the European Union, as well as to additional standards that are generally accepted for valuation procedures in the Member States. Prior opinions can be given in the context of other transactions of the company, tax valuations or litigation. However, whether these previous estimates include fair opinions must be judged on a case by case basis. Finally, it is not clear whether the "effective date of the asset contribution" mentioned in the Directive is the date of the conclusion of the agreement or the date of its execution. According to the majority opinion, it refers to the date at which the risks are transferred to the company, namely the second date, but it can be otherwise agreed.

Again, if new circumstances that can significaly alter the fair value of the assets at the effective date of its contribution, the management body is compelled to carry out a revaluation, according to the rules of art 10 (1), (2) and (3) of the Directive. Failing of the board to act for a revaluation, the Directive, in view of the protection of the shareholders' rights, establishes their right to demand an independent valuation. The requirements are that the shareholders who request it hold a total of at least 5% of the subscribed capital on the day of the decision on the increase in capital, that their request is submitted until the date of the effect of the contribution and that they maintain hold of the 5% of the capital at the day of their request.

Finally, for assets other that the securities and instruments, expert valuation is not necessary if their fair value can be derived from the statutory accounts of the previous financial year, after being subject to the audit of Directive 2006/43/EC (8th Company Law Directive). This rule is also connected to the application of the IFRS standards on fair valuation and the accounts that can be used as a point of reference can either be solo or consolidated accounts of the contributing company. In the event of new qualifying circumstances, the obligation of the board for revaluation and the right of the shareholders still applies.

In the cases where the expert valuation is dispensed with, there are additional requirements of publicity to be followed by the management board. According to article 10 (b) (now article 12 Dir. 2012/30/EU), a declaration must be published within one month after the contribution. It must include description of the consideration, its value and method of valuation and whether the assets contributed correspond to the value of the capital. Finally, a statement is required that no new qualifying circumstances as to the value of the assets have occurred after the initial valuation.

The Directive adequate safeguards to be taken by Member States to ensure implementation of the rules on asset valuation. Measures for ensuring implementation could be the liability of the directors or intervention of the national authorities, as for example notaries, as well as the liability of the independent experts.

In the case of capital increase considerations in kind are regulated by article 27 of Directive 77/91. According to par 1, they must be fully transferred within five years from the decision for the increase of capital. The independent expert report is required in this case also, before the increase in capital is made, according to articles 10 (1), (2), (3). Exceptions are found in the increase of capital following a merger or a public offer for the purchase or exchange of shares in order to pay the shareholders of the target company. Finally, the expert report is not necessary when all the shares are issued for a consideration other than cash to one or more companies, if all shareholders agree and the requirements of article 10 (4) (b) to (f) are met.

After the amendments, in case of non cash considerations taking place without an expert report (article 10(b) par 2 Directive 2006/68/EC, now article 12 par 2 in the recast), an announcement must be published according to Article 3 of Directive 2009/101/EC, which will include the date of the decision on the increase and the content imposed by the of article 10b before the contribution becomes effective and the declaration pursuant to paragraph 1 of this Article shall be limited to the statement that no new qualifying circumstances have occurred since the aforementioned announcement was published.

To conclude, the new rules attempt to promote the simplification of in kind contribution, however the requirement of expert valuation is not completely eliminated, but only set aside for the specific cases for which valuation has already taken place. For these cases, as well a number of terms and conditions still have to be observed.

Capital Maintenance-

Prohibition of distribution of dividends to the shareholders and acquisition of own shares

Capital maintenance, in the form of the restrictions on the distribution of company assets to the shareholders, has been characterized as the core element of any meaningful legal capital regime. The purpose of the rules on the raising of capital for the protection of creditors would be nullified if the company had the freedom to redistribute assets that were received from the shareholders back to them. The importance of rules on capital maintenance is justified by the fact that they reduce the possibility of the insolvency of a company, because all the initial equity contribution remains to the availability of the company. It is accepted as a general rule that, ceteris paribus, the lower is the rate of debt to equity, the lower is the chance of insolvency of the firm. Creditors' interests can be harmed even if the company does not actually become insolvent. Additionally, the capital maintenance rules related to the distribution of capital to the shareholders and the company's rights to acquire own shares are important for the execution of the company's commercial activities. On the other hand**,** the capital maintenance rules entail costs, as the costs of compliance for a company and furthermore can result in preventing useful corporate transactions, such as the leveraged buy-outs.

These limitations are a core element of any legal capital regime. However, prohibitions limiting the distribution of assets specifically to the shareholders as members of the company can also exist independently from the concept of legal capital, as demonstrated by the rules relating to the British private limited company and US corporation law, as for example Section 6.40 of the Revised Model Business Corporate Act.

Restrictions on distribution of cash to shareholders

According to the provisions of the directive, profit distributions have to be funded exclusively from profits of the last fiscal year or from retained profits of prior periods. In some continental European countries this regulation with some variations applies to all kinds of limited liability companies, but the Second EU Directive only applies to public companies. Distributions are permitted only from a nominal capital "surplus" calculated from the difference between total equity and the sum of subscribed capital, legal reserves and statutory reserves as Art. 15 par 1 (a) of the Directive sanctions.

The basic rule is included in article 15 (1) (a) and (c) and 16 of the Directive 1977/91/EEC and new articles 17(1) (3) and 18 of the recast Directive 2012/30/EU. The Second Directive establishes two cumulative conditions for payment of dividends: first, the latest annual accounts of the company must show that the net assets of the company are not, or following such a distribution would not become, lower than the amount of the subscribed capital plus those reserves which may not be distributed and, second, the amount distributed to shareholders may not exceed the amount of net profits at the end of the last financial year plus any profits brought forward and sums drawn from reserves available for this purpose, minus any losses brought forward and sums placed into a reserve in accordance with the law or the statutes.

The Board of Directors may use the capital to finance the business activities of the company, however, there can be no distribution of profits when the net assets of the company are lower than the subscribed capital plus the legal reserve. The capital and the legal reserve remain bound and cannot be distributed. Any distribution contrary to this rule must be returned by the shareholders, provided that the company proves that they knew or they could not have been unaware of their irregularity (article 16). The definition of distribution is very broad and includes the redemption or repurchase of shares. It covers a wide range of transactions through which the company assets are directly or indirectly transferred to shareholders for less than market value.

The main objective of capital maintenance regulation in the Second EU Directive is to ensure that cash and assets, once they are brought into the corporation, can only be redistributed to shareholders upon compliance with the restrictive requirements of a capital reduction. Dividend payments are limited to the nominal amount of retained earnings and profits of the reporting period. Capital may not be returned to shareholders.

Acquisition of own shares

Article 18 of the Second Directive before its amendments established the rule that the direct or indirect subscription (e. g., through a controlled company or the parent company) for own shares by the company itself was forbidden (par 1, The shares of a company may not be subscribed for by the company itself.). According to the Directive, the persons or companies or firms who signed the statute of the company and -in cases of an increase in capital- the members of the management body are liable to pay for shares subscribed in contravention of the prohibition. The aforementioned persons can be released from their obligation if they proved that no fault can be attributed to them personally. Acquisition of own shares is permitted in the case of distribution to the employees of the company or when it was considered necessary for the stabilization of their market price.

The reasoning of the strict prohibition is the protection of creditors against a substitution of the assets of the company by its shares, which in that case would not represent an external value. Additionally, they aim at preventing illegitimate transactions such as granting a shareholder the right to leave the company or the directors the possibility to acquire cash from the company in exchange for their shares.

The acquisition of own shares under the laws of the Member -States must be subject to the obligatory requirements of article 19. The general meeting of shareholders must authorize such an acquisition and determine the duration of the effect of the authorization, which maximum length cannot exceed eighteen months. The general meeting determines the maximum number of shares to be acquired and, in case of acquisition for value, sets the minimum and maximum consideration. The management body is responsible to assure that a number of conditions are met at the date of effect of the acquisition: The nominal value or the accountable par of the shares acquired by the company or by a person on the company's behalf, may not exceed 10 % of the subscribed capital or of the total number of shares. The acquisitions may not have the effect of reducing the net assets below the amount of subscribed capital plus those reserves which may not be distributed and, last, only fully paid-up shares may be included in the transaction.

Exceptions from the general meeting decision are found in paragraphs 2 and 3 of the same article, namely the acquisition of own shares to prevent serious and imminent harm to the company, in which case the management body has the obligation to inform the next general meeting of the terms of the acquisition, and when shares are acquired for distribution to the employees of the company or an associate company, where the distribution must take place within 12 months of the acquisition. Article 20 sets a number of exceptions to the preconditions of article 19 in paragraph 1 (a) to (h), however, these shares also had to be disposed of within a period of three years (article 20 par 3) if exceeded 10% of the subscribed capital, or they were automatically cancelled with or without a reduction of capital.

Article 22 sets as minimum conditions for the holding of the company' own shares the suspension of the voting rights of the shares and the provision for an undistributable reserve of the same amount that shall be included among the company's liabilities, if shares are included among the assets shown on the balance sheet. Finally, the information required in paragraph 3 must appear on the annual report of the company. These provisions aim at protecting the company from losses when the shares are cancelled, as well as to define the limits of authority between the general meeting and the management board since the latter cannot exercise the relevant voting rights and disturb the balance of power in the general meeting.

However, these rules have been considered obsolete under the developments of the financial markets, since now the buy backs are used as a means of returning excess cash to the shareholders. The transactions are announced and take place in public markets. They are considered important for the support of the market price of the shares, which results in the improvement of the financial condition of the company and its protection against hostile takeover bids. In practice, the acquisitions are regularly authorized by the general meeting, since the shareholders are the beneficiaries. The limit of the 10% can be circumvented if the transaction is spread over two accounting years or if a formal reduction of capital follows.

The criticism led to the revision of the rules that were included in the Directive 2006/68/EC.

Under the new regime, the rule is that acquisition of own shares is permitted with the fulfillment of certain conditions that have been revised. (Member States may permit a company to acquire its own shares, either itself or through a person acting in his own name or in the companies behalf). As a result, the Member States have a wide discretion as to they will permit this action or completely forbid it.

Paragraph 1 sanctions that the acquisition of own shares must be done without prejudice to the principle of equal treatment of all shareholders who are in the same position. This principle was found already in article 42 of the Directive 77/91/EEC. The governing board must acquire shares from all shareholders, according to the percentage of participation in the share capital and in the same average price. There can be no abusive conduct at the expense of a specific group of shareholders, or abusive behavior of the board in order to change the structure of the share capital. The decision regarding the acquisition of own shares belongs to the competence of the general meeting, as all the decisions concerning changes in capital, such as the increase and reduction of capital, as well as the distribution of profits. This ensures that the information reaches all the shareholders, protecting the interest of the minority, as well, since they can review the decision. The authorization of the general meeting constitutes an ex ante consent and not an ex post approval.

The effect of the authorization of the general meeting is no longer limited to eighteen months but, depending on the provision of national laws, may last for up to five years. This change helps in avoiding regular renewals and overcoming difficulties in authorization that derive possibly from institutional shareholders, who view such a decision as a method for the avoidance of take overs. However, this regulation strengthens the position of the controlling shareholders.

The permissible amount to be used for acquisitions is the total amount of the own funds, minus capital and undistributable reserves.

In addition, the amended Directive sets as optional the application by the Member States of the following requirements: The nominal value or accountable par of the shares acquired may not be lower than 10% of the subscribed capital, namely it can extend from 10% up to the amount of the distributable net assets (article 15(1) (a) and (b). This limit includes the newly acquired shares, along with the shares already in possession of the company, as well as the shares that a natural person acquires in their own name, but on behalf of the company. The new limit constitutes the main difference of the new regulations, corresponding to the notion that all assets of the company are distributable under whatever form, provided the amounts corresponding to capital and undistributable reserves remain within the company.

Additionally, optional are the provisions in the statutes of the company of the maximum shares to be acquired, the duration of the authorization and the minimum and maximum consideration, as well as the requirements of reporting and notification, in addition to the disclosure requirements of art. 22(2), the obligation to cancel the shares, in addition to art 20 (2) and the prejudice to the satisfaction of creditors' claims, in which case the national law could impose the company to constitute a guarantee (comp. art 32 of the Second directive). These requirements are mostly important for the unlisted companies, in order to protect the creditors, but also the relationship among shareholders.

If the company acquires own shares without complying with the conditions set, then according to article 21 (now 23), it is obliged to dispose them within one year of their acquisition. The question arose in theory as to whether a time limit exists for the holding of the shares that are acquired legitimately. In the Directive, no provision for such a time limit exists. The company can hold the shares indefinitely and dispose of them at will. There would be a possibility, though for the member states to enact provisions setting a time limit for the holding of own shares, based on the consideration that article 22 of the Directive for the holding of the shares is a rule of minimum harmonization, which consequently permits the Member States to establish rules stricter than the ones it contains.

Given the significance of the share buy backs in modern markets, the revision of the 10% threshold is an important step towards the flexibility and the simplification of the existing regime. However, the restrictions of the directive have been softened, but not completely abolished.

Financial assistance

The rules of the Directive on financial assistance have been characterized as ancillary, in the meaning that they only have a distant connection to the rules of the legal capital maintenance and their presence in the text of the Directive is not justified.

Under Directive 77/91/EEC the rule was that financial assistance from the company to a third party in order to acquire its shares was forbidden. (Article 23 (1), A company may not advance funds, nor make loans, nor provide security, with a view to the acquisition of its shares by a third party.). The breach of this rule has severe legal consequences, depending on the national laws: transactions such as agreements on granting suretyship by the company, or on creating pledges on its assets can be deemed to be null and void and bring civil or even criminal liability of the directors. The liability could be extended to third parties, such as banks, when participated in a prohibited transaction.

This restriction has been debated in company law. The reasoning behind the prohibition is creditor and shareholder protection, the prevention of manipulation of the market price of securities and restrain abusive practices in take overs. Nevertheless, the rule was considered restrictive for beneficial transactions for the company, as leveraged buy-outs, acquisitions of subsidiaries and private equity transactions. Furthermore, it was supported that that financial assistance to a third party should be considered on the terms of its creditworthiness and the impact on solvency of the company rather than imposing an outright prohibition of any transaction. Thus, such a decision is a matter of the management prudence, which will specify its conditions and the necessary guarantees. Finally, the complexity of the rules lead to the seeking of costly legal advice. The criticism has gone so far as to ask for the complete abolishment of article 23.

In order to make funding of buy- outs more flexible, the revision of the restriction was deemed necessary. According to the fifth recital of the 2006/68/EU Directive, the flexibility regarding changes in the ownership structure of the share capital, at which the new rules on financial assistance aim, falls under the objective of the protection of shareholders, along with the third parties. Under Directive 2006/68/EC the member states can either maintain the prohibition or abolish it, however under some strict prerequisites:

The management body must submit the transaction to the general meeting for ex ante approval which must decide under the special majority and quorum rules established in article 49 of the Directive, namely not less than two thirds of the votes attaching to the securities or the subscribed capital represented, or simple majority when least half the subscribed capital is represented.

A written report by the board to the general meeting must state the reasons for the assistance, the relating interest of the company and the conditions of the transaction, the risks concerning the liquidity and solvency of the company and the price at which the shares will be acquired by the third party; this report must be published accordingly (art 3 Directive 68/151/EEC).

The transaction must take place at the initiative and under the responsibility of the board, which must ensure fair market conditions, especially with regard to interest received by the company from the third party and with regard to security provided to the company by the third party for financial assistance in the form of loans and advances. The credit standing of the third party or of each counterparty in the case of the multiparty transactions must be duly investigated.

The aggregate financial assistance must not lead to the reduction of the company's net assets below the subscribed capital plus the undistributable reserves minus the uncalled capital in the event it is not shown in the balance sheet. This restriction demonstrates the EU political choice to support the legal capital doctrine, despite the criticism from scholars. Finally, if financial assistance is used by the third party to acquire shares which the company holds in its treasury or to subscribe to newly issued shares, then the acquisition must be made at a fair price. Possible conflict of interests between the shareholders and directors may arise, that are to be dealt according to the laws of the Member-States.

The measures taken in the Directive aim at the protection of shareholders' interests through a series of procedural requirements, but are not considered as always feasible in regard to the normal operation of a corporation. The submission to the general meeting, in particular, for an ex ante and regarding a specific transaction approval and the prior report of the management board can hamper the provision of financial assistance, especially to listed companies, in the context of the rapidity of modern transactions. The time-consuming procedures which can incur further costs mitigate the effect of the lifting of the ban. On the other hand, steps have been taken on the introduction of solvency requirements, standards-based fiduciary duties (fair price) and disclosure duties. In conclusion, the provisions constitute a step towards a liberalization of the financial assistance, with limited however practical application.

Increase in the company's legal capital

The need for additional corporate funding is the reason for the increase of share capital. This increase is accompanied by the inflow of new assets in the company, namely the share capital and the corporate assets increase equally, increasing simultaneously the creditworthiness of the company. Consequently, although share capital is a legally fixed amount, it can be increased by amending the statute of the company. The increase can either be real, with new incoming financial assets or nominal, with the commitment of distributable assets of the company as non-distributable ones. The increase of capital is recorded on the liabilities side of the balance sheet, and therefore, in order for a distribution to the shareholders to take place, the balance sheet assets must exceed the liabilities side.

In the public limited liability companies, there is increased separation of control and management. The general meeting has the decisive authority in transactions related to the increase or reduction of the capital, regarding the significance of such decision to the company and the creditors. The general meeting of the shareholders decides for the increase in capital according to article 25 (1), Dir. 77/91. The decision is subject to the publicity of article 3 Dir. 68/151/EEC, according to the laws of each Member State. The general meeting, however, can provide authorization for a maximum period of five years to the management board to decide for such an increase.

In the case of several classes of shares, the decision of the general meeting for the increase must be subject to the separate vote of at least each class of shareholders, whose rights are affected from the increase of capital, because, for example, of a decrease in the participation in the profits of the company or of the issuance of new preference shares with additional privileges to the existing ones.

As in the initial payment of capital, according to article 26 the shares that are issued for a consideration must be paid for at least 25% of their nominal value or accountable par; the issue premium must be paid in full. The consideration for the new issued shares can either be in cash or other assets. By article 27, the consideration in kind must be fully paid within five years from the increase decision. A valuation report by independent experts appointed or approved by the competent administrative or judicial authority must be submitted with the content specified by the rules of art 10 (2) and (3) of the Directive -taking into consideration the new articles 11 and 12 of the recast

Directive 2012/30/EU.

According to Article 28, where an increase in capital is not fully subscribed, the capital will be increased by the amount of the subscriptions received only if the conditions of the issue so provide.

The increase in the share capital can affect the rights of the shareholders by altering their share of participation in the company, when the newly issued shares are available to third parties. The position of power of the majority shareholders can be threatened, while the rights of the minority shareholders can be degraded, while the participation in the distribution of the profits is diminished. For this reason, for the new shares that are issued for a consideration in cash, the existing shareholders are given a pre-emption right in proportion of the capital represented by their shares in cash (article 29).

According to par 4 of the same article, the general meeting may reach a decision under the rules of qualified majority to restrict or withdraw this right, after the submission of a written report from the management board explaining the reasoning for such decision. The shareholders can also decline the shares offered to them.

Reduction of the share capital

There are various reasons a company can decide a reduction in capital. In the case a company does not need a part of its capital, because it has ceased a sector of its business activity, it returns it to the shareholders. In this very rare case, a real reduction of the capital will take place. However, when losses occur and the aggregate corporate assets fall below the amount of the share capital, the company may be obliged to reduce its capital in order to avoid deficit in its balance sheet, so as to be able to make distributions to shareholders and secure creditors' interests. In this case, a nominal reduction of the capital may take place in order to adjust the capital to the new diminished corporate assets.

Nominal reduction of capital can simultaneously be combined with a real increase. Because the company cannot issue shares below par, the nominal reduction must precede so that the capital value adjusts to the company's assets and the internal value of the shares increases to comply with their nominal value. The subsequent increase will lead to the inflow of new assets in the company so that a distribution of profits to the shareholders is possible in the next financial year.

Article 21 (new 23) of the Directive 77/91 provides for a case of an obligatory reduction in capital. When the company acquires its own shares contrary to the prescribed procedure and fails to dispose of them within one year from their acquisition, these shares must be cancelled and a reduction of capital must follow if after the cancellation of the shares, the net assets fall under the minimum capital plus undistributable reserves.

Article 17 of the Second Directive provides that in the case of a serious loss of subscribed capital, the general meeting which will be called within a time period specified in national laws in order to decide whether the company should be dissolved or other appropriate measures should be taken. The considerable loss of capital is to be defined by the Member States, but may not exceed half the authorized capital. One of the methods commonly used in practice for the restoration of authorized capital sufficiency is the reduction of the authorized capital to the level where the company's equity capital amounts to no less than ½ of the authorized capital referred to in the statutes.

As to the procedural requirements, according to article 30 (now 34), the reduction of capital requires the decision of the special resolution of shareholders deciding with the rules of qualified quorum and majority under article 40, which must be published according to article 3 Dir. 68/51/EEC (2009/101/EC). The notice of the meeting must include the purpose and method of the reduction. Article 31 (now 35) requires that when there are several classes of shareholders the decision must be subject to separate vote from at least the classes of shareholders whose rights are affected. The same rules of quorum and majority apply. Reduction of capital only takes place after amending the articles of the company statute.

Article 32 sets strict requirements purporting to the protection of creditors in case of a capital reduction and in particular in deterring cash payments to the shareholders to the detriment of the creditors' interests. Consequently, member states have to sanction that no payment to the shareholders can take place or alternatively the reduction is void, until the due claims of the creditors are satisfied or rejected by a court decision. (par 2).

For the claims created prior to the publication of the decision for the reduction which have not become due by that date, the provision of security is mandatory (par 1). After the amendment of article 32 with the Directive 2006/68/EC, a subparagraph was added to the article which establishes the right of creditors to apply to the competent administrative or judicial authority of the Member State to prevent a distribution to the shareholders for which they have to prove that the reduction in the capital jeopardizes their claims and that the latter have not been secured.

The reduction of capital may not result in an amount below the minimum requirement set by the law (article 34, now 38). This reduction may be permitted if a simultaneous increase of the subscribed capital to an amount at least equal to the minimum takes place or it is decided that the company is converted to a different corporate form, for example private limited company.

Criticism on the legal capital regime -Future Developments

The traditional legal regime established in the Second Company Law Directive has been subject to strong criticism as to whether it fulfills the objectives for creditor protection, it promotes business efficiency and competitiveness and is justified in the context of the Single Market and the globalized modern markets.

First of all, the scope of the Directive includes only public limited liability companies, which were considered the most important business firms at the time the Directive was established. In some jurisdictions, however, the same rules apply to private limited companies, as well. As a result, there are countries within the EU, where the rules apply to both public and private limited companies, whereas in others some part of rules applies to limited companies. This way, an alternative to the application of the mandatory rules is offered. This effects the degree of harmonization achieved by the Directive.

Additionally, the Directive includes rules of minimum harmonization and as a result the Member States can and have taken additional creditor protection measures within their legal orders (concerning the share premiums for example). As a result, the evaluation of the protection offered by the Directive is ground on a combination of the rules set in the Directive and the related national rules.

Moreover, the conditions in the financial markets have changed in comparison to the time the Directive was introduced. Company financing does not rely on bank financing or private shareholders to the same extent as in the past, but rather on the public markets by means of issuing shares, bonds and other instruments or securitizing other financial assets. As a result, the rules provided in the Directive do not address the issues arising from the contemporary financing operations. In addition to that, the position of shareholders in the operations of the company, concerning take overs, corporate governance and shareholders rights has been amplified in relation to the creditors, creating the need for different ways of protection.

Besides the differentiated context, there are arguments from the economic analysis of law point of view against the mandatory provisions of the capital. The minimum capital requirement of 25,000 € set in Article 6 (1) of the Second Directive applies to all stock companies without considerations of size and risks involved in the specific business activity and the national laws have the discretion to decide the amount of minimum capital required uniformly for all types of companies, irrespective of the fact that each company may have different requirements in capital.

The existence of a minimum capital does not necessarily guarantee financial capacity of the company for the pursuance of its economic activity. On the contrary, it is used as a threshold by national governments to prevent incorporation of public limited liability companies that do not conduct real activity and to control the rate of public limited liability company incorporation. The requirement of the minimum capital in conjunction with the restrictions on contributions in kind can constitute an impediment for the establishment of new and innovative companies. Additionally, it is questioned if the legal capital is efficient for creditor protection, because it cannot prevent the insolvency of a company due to managerial errors or negative conditions than can occur in the course of business.

Furthermore, the authorized capital may be used to fulfill company obligations at the stage of incorporation, resulting to its expenditure. For this reason rules on disclosure on the amount of authorized capital are provided for in the Directive. The requirement for public registration of authorized capital and its sufficiency serves as a guarantee to the company's creditors. However, the majority of creditors, especially in major markets, will require the provision of additional safeguards for the fulfillment of the obligations of the company, such as mortgage of real estate, pledge of shares, surety or guarantee by the parent company.

The provisions of the Directive are criticized for lack of flexibility, concerning the processes of capital restructuring that a company may face during its operation. Forms of corporate restructuring activities such as leveraged buy-outs, pay-offs of dissenting shareholders and capital restructuring activities in the course of a crisis, are prevented by the restrictions on the distribution of capital and capital reduction is considered a costly and complicated procedure.

The alternatives to the mandatory creditor protection

The shift of the objectives of European Company Law from the need of creditor protection to the business efficiency and competitiveness was reflected in the European Commission 2003 Action Plan on the Modernizing of Company Law and enhancing Corporate Governance. The discussion concerns the future developments on the Second Company Law Directive and the legal capital regime. The academic opinions expressed range from the support of moderate changes in the Directive to the complete abolishment of the specific legal capital regime.

The use of alternative solutions for creditor protection (creditor self-help) in contrast to the mandatory rules established in the Second Directive is suggested. Possible solutions are the collecting of information on the company, receiving third-party credit insurance, the use of covenants in the contract and securing claims with collateral from the corporation or its directors and shareholders. There are legal orders, such as the British, which favor these solutions over the mandatory rules, while in others the dominant tendency is in favor of preserving the existing regime.

One point of criticism is that the alternatives incur additional costs for the creditors. This is true for information gathering, as well as for obtaining third-party credit insurance, for writing and contracting covenants and for supplying collateral and personal guarantees. Consequently, according to the view supporting the preservation of the mandatory rules, the statutory limitations excel, because they offer a safer, less costly and more efficient solution. According to this view, the Directive offers protection to the weaker creditors, including involuntary- tort creditors, addressing effectively collective action problems.

As regards to the covenants, namely contractual terms in the debt agreements of the company with the creditors, as a means of creditor protection, it is stated that only big creditors, such as banks, have the financial power to impose covenants, in contrast to the weak creditors. Nevertheless, the latter can benefit from the covenants of large creditors as free – riders. However, some clauses can have a negative spill-over effect, such as the event-risk clause or poison-put clause, according to which bondholders have an option to put the bonds back to the issuer. The activation of such clause deprives the company of the necessary liquidity to fulfill its obligations, resulting to the detriment of the rest of the (non secured) creditors.

The opposing view supports the use of covenants as they can offer a greater degree of flexibility in comparison to the rigid rules of the Directive, can be negotiated on a case by case basis and are adapted to the specific circumstances of the loan agreement. For example, in the alternative regime (USA), covenants that restrict the distribution of dividends to the shareholders can be omitted in the cases where such a restriction is found unnecessary, as for example in the cases of firms with high growth.

This view also supports that the Directive does not protect effectively weak and tort creditors specifically, since the minimum capital is not adapted to the specific financial requirements of specific companies. The balance sheet information on which the prohibition on distributions and reductions of capital are based do not necessarily reflect the true financial position of the company and its ability to pay its debts as they fall due. The restrictions cannot protect the creditors from potential losses taking place in the normal course of business and article 17 offers limited protection in this context. Finally, the share premiums do not constitute part of the non- distributable assets of the company under the Directive.

Ex post regulation of profit distribution (Solvency test) - Wrongful trading provisions

The proposals of the High Level Group already included an alternative regime based on a solvency test and the adoption of rules on wrongful trading. The solvency test can address the shareholders' and creditors' conflict of interests by regulating the distributions to the shareholders ex post, taking into account the solvability of a company after the distribution has taken place. It is used in the USA and other jurisdictions of Anglo-Saxon origin.

The test includes the solvency declaration by the directors of a company as to the effect of a distribution to its solvency. The declaration must confirm that the distribution does not affect the going concern status of the company for the period of time set by law. An inaccurate declaration entails severe personal liability for the directors.

The solvency test can either be based on a balance sheet accounting calculation or a test on the liquidity of the company. According to the first method, if it is proven that after a distribution the difference between the liquidation values of the assets and liabilities is positive, then the distribution is permitted as not affecting the claims of the creditors. According to the second, if the free cash flows of future periods can ensure the solvency of the company after a distribution, then the latter can take place. The length of the period for this prediction is debated, but on average it is set to 12 months.

The wrongful trading provisions entail liability of the directors when a company continues to engage in business activities despite the fact that they knew or ought to have known that insolvency of the company was unavoidable.

The introduction of these regulations in the European corporate law is beneficial for the protection of creditors as it can ensure fulfillment of their claims based on solvency data and the future perspectives of a company and corresponds to the international legal developments and requirements of financial markets.

Despite the intense criticism, the changes that have taken place in the Directive were moderate. There were some steps taken towards the facilitation of procedures that are beneficial to the company and necessary under the modern market conditions, as are the valuation of contributions in kind, and an attempt to a greater flexibility for share buy backs and provision of financial assistance for the facilitation of beneficial transactions to the financing of the company. However, the interests of the creditors still remain the main focus of the Directive and the restrictions and procedural requirements that the Directive sets and preserves seek to achieve that purpose.

The discussion is still ongoing and has not yet concluded that the proposed alternatives excel and the regulations of the Directive have to be repealed and substituted by the new solutions. The alternatives, however, are discussed as a possibility.

Of course, multiple factors are taken into consideration when examining the possibility of change in an established regime. Cost and benefit analysis of the existing and future regime along with transitional costs, the established legal tradition of Europe which cannot be altered with ease along with the economic and political context. It is a matter of policy decision if creditor protection must be an objective of EU law or left to the regulation of the Member States and if adoption of new measures will take place under terms of maximum or minimum harmonization.

All these considerations determine the choice of a radical or conservative change. Nevertheless, the efficiency of the changes can be judged after their implementation in practice.

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